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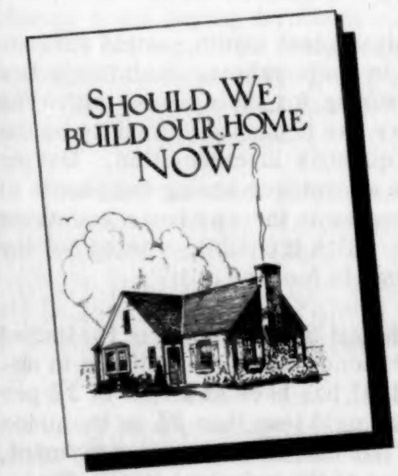
As I see it

SHOULD WE BUILD OUR HOME NOW ?

ON September 15, 1939, about 2 weeks after the war started in Europe, I wrote a booklet entitled, "Should We Build Our Home Now?" This was an answer to a theoretical letter from John and Mary Smith, wanting advice on their problem. After giving many cost figures and advising them to go ahead as quickly as they could, I ended with this paragraph:

"My personal opinion is that the present World War will necessarily bring on a world-wide inflation. All of the European governments involved were heavily in debt at the time the war started. The prosecution of the war will increase tremendously this indebtedness. It will reach such heights that it can be paid only by reducing the value of money. Any great degree of inflation over a large part of Europe will pull the United States in the same direction. In a period of inflation, it is quite difficult to safeguard one's principal. I know of no better hedge against inflation than an equity in a residence in which the family lives. Past experience has indicated that the great body of home owners has too much political influence to be ignored. During the past depression a tremendous amount of legislation was passed to protect the home owner and his investment. Regardless of what restrictive legislation might be passed during a period of inflation, I believe that the home owner would be in a favored position."



If the children of John and Mary Smith were to ask my advice today on building a home, what would be the answer in view of the fact that since I wrote this booklet 19 years ago the cost of a typical residence has gone from \$8,200 to \$22,862, an increase of 179%?

Let us admit frankly that conditions are totally different than they were when I advised the immediate purchase or construction of a home.

Among factors which are different than they were in 1939 would be these:

1. At that time real estate had been in a readjustment period for 10 years, as the big real estate boom of the 1920's ended in 1929. At the present time we have been in a real estate readjustment period for 1-1/3 years, as the longest real estate boom in the history of the United States came to an end in the spring of 1957.

2. A world war had just started in 1939, which made a high degree of inflation inevitable. At the present time I believe that the prospect of any large war is relatively remote, in spite of all the international tensions which exist.

3. When I wrote the booklet "Should We Build Our Home Now?" I believed that a tremendous real estate boom was imminent. At the present time it seems to me that the next real estate boom is still some distance in the future. I will be surprised if we go into a real estate boom again, of the type we recently came through, within 5 years, and it may be much longer before one of these irrational booms develops.

4. I doubt very seriously whether our period of real estate readjustment is completed. At no time in the past history of the United States have we experienced a real estate readjustment of less than 6 years, which would indicate that if the past is to be any guide to the future, we cannot expect a new boom to develop overnight.

In other words, it seems to me that the prospect of rapid increases in real estate values comparable to those we had from 1939 to 1947 is not probable, as these were largely the result of the war.

However, my advice to John and Mary Smith at the present time, in most cases, would be to buy or build on today's market. I am listing my reasons below.

1. As I pointed out in my "As I See It" Bulletin last month, world currencies are all experiencing a downward trend in their values. Relatively few countries have had either a gold or a silver backing for their money since the 1930's. The value of the money in each country has depended primarily on the restraint of its government in increasing the quantity in circulation. During this period the Nursemaid State has gained wide acceptance among the people of the world, with the result that the legislative bodies in the various countries have been anxious to spend money for projects which the public wanted but for which it was not willing to pay taxes heavy enough to foot the bill.

With the prospect of the largest peacetime deficit in the history of the United States it would be irrational to assume that our money would not continue to decrease in value. The average decrease since 1941 has been at a rate of 3% per year. This means that any investment which has paid less than 3% on the principal during the period from 1941 to the present has not, in the interest payment, compensated for the loss in the purchasing power of the principal itself. Since,

however, any interest earned on the investment is income on which income tax must be paid, an interest rate considerably in excess of 3% is needed in order to conserve principal.

Let us use as an example a person who bought a $1,000 "E" bond in 1941. If the "E" bond is turned in today, the investor will receive his original principal plus approximately 3%. He will find that the purchasing power of the money he receives is approximately 20% less than the amount he invested 17 years ago. Since he must pay Federal income tax on the $460 worth of interest he has received, and since the lowest percentage which he could pay on taxable income would be 20%, this would subtract a minimum of $92 from the $460, with the result that the best he could do would be to sustain a loss of 22% in purchasing power for lending his money to the Government for 17 years. If, on the other hand, this individual were in the 91% tax bracket on the last increment of his income, he would find himself, after having loaned his money to his Government for 17 years, with a capital loss in purchasing power of 48% after paying his Federal income tax.

The same principle which applies to Government bonds applies to all other types of bonds, savings and loan shares, and any other investment which pays back a given number of dollars.

If it is conceded that inflation will continue, the only alternate investment for the average family other than a home would be well-selected common stocks.

2. The purchase of common stocks for the average investor at the present time is risky. Because of the fear of inflation the prices of stocks have now been bid up to the point where the earnings of a stock in relation to its selling price are very low in comparison to these price-earnings relationships of the past. The average company represented by shares on the New York Stock Exchange is not paying dividends high enough to justify the price for which its stock is selling. This being true, there is always a great probability that the historical patterns of the past will repeat, and that selling prices will decline until they are more in line with what the public has customarily expected as a return on its investment.

The movements of stock prices can be sudden and drastic. While I realize there is some danger of stock prices being bid up still further by investors in their flight from the dollar, in which case this final burst of speculation would collapse largely as the market collapsed in 1929, it seems to me that this will not happen. I think the Federal Reserve would try to tighten the money supply to prevent this sort of upsurge and collapse.

3. At the present time financing terms on real estate are more favorable than they have been during the greater part of the 75 years covered by our figures. This is due to the special effort which has been made to stimulate construction as an antidepression measure. A house purchased on today's market

financed with a 20- or 25-year loan will tend to stabilize the owner's housing cost at a point very close to today's level. The great probability is that houses built 10, 15, or 20 years from now will cost much more, and persons buying then will have a monthly housing cost much higher than the cost today.

4. The cost of not buying a house at the present time I think is certain to increase. By this I mean that residential rents are still very low in comparison with their historical pattern of the relationship to construction costs and to the selling prices of existing housing. Since a large part of the increased demand during the next 10 years will come from persons who will be in lower age brackets (20 to 35 years of age), and since persons of these ages have not furnished the great bulk of the purchasers of housing in the past, this would indicate that there will continue to be a shortage of rental units unless rents advance at a rather rapid rate, making it profitable to build large numbers of rental units. Even this cannot bring down the average rental charge in the foreseeable future, as these additional units will be built at high cost which will accordingly require a high rent to make them feasible.

5. While the assumption that an owned home provides rent-free occupancy is not valid, it is still true that an accumulation of rent receipts has little value.

6. In an inflationary period one of the great advantages of home ownership is leverage, which, of course, in the terms of the investor means that only a small part of the investment is made in cash and the balance represents indebtedness. Since the value of money will be declining and the value of the property will be increasing, the indebtedness can be paid off with dollars of lesser value, resulting in the long run in a considerable increase in the purchasing power equivalent of the investment. The ownership of one's own home is one of the few investments which can be made with a relatively slim equity with considerable safety to the investor. This is due to several factors, the first being that real estate is not subject to the rapid, drastic fluctuations of the stock market. Real estate values change slowly. It is also due to the fact that home owners have now become the dominant factor numerically in our population. Approximately 60% of our families now own their own home. Any group comprising 60% of the population will have the maximum of political protection. Any session of Congress, in an emergency, would pass special legislation to prevent any large-scale foreclosures of Veterans' loans, FHAs, or even conventional loans. Various methods would be worked out for delayed payments during a period of mortgage moratorium.

In the foregoing I am not precluding the possibility of some drop in real estate prices during the next few years. I am confident, however, that these drops will not be drastic and that the recoveries will carry values to a higher point than we have now. The only hedge I have regularly put on my advice to buy or to build is to do it only if you expect to live in the house for the next 10 years. Under these conditions I think the purchase of a home by the average family is the best inflation-proof investment it can get. In addition, it is an investment in living.

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